Introduction

There are few areas of employment law which differ as significantly between countries as the laws relating to post-termination restrictions. The increasing trend for key employees to have international responsibilities, be globally mobile, and for post-termination restrictions to apply across many different jurisdictions is a challenge. In reality when enforcement issues arise the decisions taken in the early stages of action may determine the outcome weeks or months later.

This is why the Guide to Restrictive Covenants was created, serving over 14 key countries. Within are discussions on non-compete covenants, non-solicitation covenants and non-solicitation of employees’ clauses, issues relating to employee benefits, pension, stock plans and more...

An essential publication for anyone involved in employment law, it has been compiled by lawyers from a major international law firm, as well as partner companies based in other jurisdictions.
A. OVERVIEW:

Post-employment restraint clauses or restrictive covenants are commonly used by Australian employers to protect their business interests, particularly in employment contracts for professional or senior/managerial employees.

A typical restraint clause will impose restrictions on the employee not to work in any capacity for a competitor, for a specified period after they leave the employer’s business; not to solicit their former employer’s clients, customers or staff; and not to use their former employer’s confidential information.

These types of clauses operate subject to the common law doctrine of ‘restraint of trade’. This means that a restraint clause must be directed at protecting specific interests of the employer (such as trade secrets or business goodwill). The courts will not uphold a restraint clause that restricts competition per se, or unduly interferes with an employee’s right to sell his or her own labour.

In assessing the validity of a restrictive covenant, an Australian court will determine whether the restraints imposed on the employee are reasonable having regard to their duration; the geographic area in which they apply, and the activities of the employee that they seek to control.
Australia

There is some capacity for a court to sever a restraint clause that it finds to be unreasonable, enabling the reasonable elements of the clause to be enforceable against the employee. Except for the State of New South Wales (where specific restraints of trade legislation applies), severance is usually only possible where the clause contains a series of overlapping restraints, known as a ‘step’ or ‘cascading’ restraint clause.

An employer will usually seek to enforce a restrictive covenant against a former employee through an application to a Federal, State or Territory court for an interlocutory injunction. Other remedies that may be available include a permanent injunction or an order for damages.

B. NON-COMPETE CLAUSES: Can an employer require a post-termination non-competition covenant from an employee?

An employer cannot unilaterally impose such a covenant upon an existing employee, although the employer can condition any new offer of employment upon the prospective employee (and sometimes on the offer of a promotion) into such a covenant. The inclusion of a restraint clause in an employment contract is a matter to be negotiated between the employer and employee. However, as indicated above, such clauses are commonly entered into by senior executives, managers and other professional employees.

i. Are they capable of being valid?

Although post-employment restraints are commonly used, they are presumed to be invalid and unenforceable unless it can be shown that they are necessary to protect a legitimate business interest: Nordenfeldt v Maxim Nordenfeldt Guns and Ammunition Company [1894] AC 535.

The onus rests with the party seeking to enforce a restrictive covenant to demonstrate that the clause imposes no greater restraint than is reasonably necessary to protect its legitimate commercial interests: Lindner v Murdock’s Garage (1950) 83 CLR 628. Employers cannot use a restraint clause to protect themselves against mere competition: Stenhouse Australia v Phillips [1974] AC 391.

ii. What does it take to show they are valid (legitimate interest, drafting pitfalls to avoid)?

The legitimate interests of an employer that are recognised as supporting a valid post-employment restraint include the employer’s confidential information or trade secrets; customers and clients of the employer’s business; and the employer’s staff (each of these is explained further in the relevant sections below).

A typical post-employment restraint clause that would be upheld by an Australian court would be one of between three and twelve months’ duration: see e.g. Smith v Nomad Modular Building Pty Ltd [2007] WASCA 169 (six months); Seven Network (Operations) Limited v Warburton (No 2) [2011] NSWSC 386 (eight months). The period must be reasonable to protect the legitimate interest.

That said, a restraint clauses of two years’ duration was upheld in a recent decision of the Full Federal Court of Australia: Pearson v HRX Holdings Pty Ltd [2012] FCAFC 111. In that case, relevant factors supporting enforcement of the restraint (which also contained no geographic limitation) included:

- the fact that the former employee against whom the restraint clause was directed had access to almost all of the employer’s confidential business information, such as sales and client retention strategies;
- the former employee’s status as a key figure within the employer’s human resources consultancy, until his attempt to move to a direct competitor in breach of the restraint clause;
- the original employer’s legitimate interest in protecting its client relationships;
- the fact that the former employee received shares in the business and payment for 21 months of the two-year restraint period, as part of what the Full Federal Court described as a ‘reasonable commercial arrangement as between the parties’. 
In contrast, in Wallis Nominees (Computing) Pty Ltd v Pickett [2013] VSCA 24, the Victorian Supreme Court (Court of Appeal) refused to enforce a restraint clause which purported to prevent a former employee from working for a competitor for 12 months after his employment had ended. The Court found that the duration of the restraint was longer than necessary to protect the employer’s legitimate interests in its relationships with customers.

Wallis Nominees (Computing) Pty Ltd v Pickett also illustrates that when drafting restrictive covenants, employers must be careful not to cast the restraints on an employee’s post-employment activities too broadly; and should use ‘step’ or ‘cascading’ clauses. The Court of Appeal would not sever the parts of the restraint clause which it had found to be invalid in this case, because the restraint did not include ‘cascading’ provisions which would have enabled the unreasonable parts to be excluded and the remaining parts of the clause to have effect. As the Court stated: ‘the impugned part [of the clause] must be capable of simply being removed — as if simply crossed out with a blue pen; a court can remove words from a restraint clause but not rewrite it …’. See also Integrated Group v Dillon [2009] VSC 361; Hanna v OAMPS Insurance Brokers Limited [2010] NSWCA 267.

In New South Wales, specific legislation (Restraints of Trade Act 1976 (NSW)) enables the courts of that State to read down an invalid restraint clause, to give it the extent of operation that the court considers reasonable (irrespective of whether the clause contains ‘step’ or ‘cascading’ provisions). This legislation will apply in respect of any employment contract (containing a restraint clause) that has a close and real connection with NSW: see e.g. Provida Pty Ltd v Sharpe [2012] NSWSC 1041 (where the employer’s head office was in NSW, but the employee carried out work in both NSW and Victoria, the NSW legislation was held to apply).

iii. Is it necessary to pay an employee during the period of the covenant?

No, but this may be a relevant factor in determining the validity of a restraint clause (see Pearson v HRX Holdings Pty Ltd [2012] FCAFC 111, discussed above). At the same time, the fact that payment is provided to an employee during the restraint period will not make an otherwise invalid restraint lawful (see e.g. Tullett Prebon (Australia) Pty Ltd v Purcell [2008] NSWSC 852).

C. CONTACT PROHIBITION CLAUSES: Can an employer require a post-termination clause prohibiting contact with customers/clients?

This is a matter for negotiation between employer and employee (as explained at the commencement of section b. above).

i. Are they capable of being valid?

Yes, provided the restraint clause does no more than protect the employer’s legitimate business interests; and is reasonable in terms of its duration and geographical reach.

ii. What does it take to show they are valid?

The nature of an employer’s interest in protecting its customer base through express contractual provision binding on a former employee was described by the Full Federal Court in Pearson v HRX Holdings Pty Ltd [2012] FCAFC 111, as follows: ‘HRX had an evident interest in preserving the customer connections which are the source of its income. It is well established that an employer’s customer connection is a legitimate business interest which can support a reasonable restraint of trade where the employee in question controls the employer’s customer connections (see, for example, Jardin v Metcash Limited [2011] NSWCA 409 ...’).

In Wallis Nominees (Computing) Pty Ltd v Pickett [2013] VSCA 24, the Victorian Court of Appeal stated that the obligations of an employee under the non-solicitation provisions of a restraint clause are dependent on two factors: ‘First, that an employee must be in a position to gain trust and confidence so as to be relied on in a client’s affairs. Secondly, that the relationship between employee and client is such that there is a possibility that if the employee leaves the business of the employer he or she may carry away the client’s business with them.’
A valid post-employment restraint clause will typically preclude an employee from approaching or seeking to lure away clients or customers of their former employer, during the restraint period. Usually, such a clause will only be effective in respect of clients/customers with which the employee actually had contact during his/her employment with the former employer: see e.g. John Fairfax Publications Pty Ltd v Birt [2006] NSWSC 995.

Of course, it may be possible for an employee to avoid the application of a non-solicitation clause by establishing that the former employer’s clients ‘came to them’, rather than being approached by the employee during the restraint period.

iii. Is it necessary to pay an employee during the period of the covenant?

No, but this may be a relevant factor in determining the validity of a restraint clause (see section b. (iii) above).

D. NON-SOLICITATION OF EMPLOYEES CLAUSES: Is it possible to impose a clause prohibiting solicitation and/or hiring of former colleagues (both during and after employment)?

This is a matter for negotiation between employer and employee (as explained at the commencement of section b. above).

i. Are they capable of being valid?

Yes, provided the restraint clause does no more than protect the employer’s legitimate business interests; and is reasonable in terms of its duration and geographical reach.

ii. What does it take to show they are valid?

An increasing tendency in recent Australian case law is the recognition of an employer’s legitimate interest in the maintenance of a stable workforce, through post-employment restraints prohibiting an employee from poaching his/her former employer’s staff: see e.g. BDO Group Investments (NSW-Vic) v Ngo [201] VSC 206; Informax International Pty Ltd v Clarius Group Limited [2011] FCA 183.

However, post-employment restrictions on poaching or soliciting other employees of the former employer will not be enforceable in certain situations – for example, where those employees simply respond to a general employment advertisement (Allied Express Transport Pty Ltd v Mears [2010] NSWSC 1112); or there is other evidence that the employee subject to the purported restraint has not initiated contact with or sought to persuade those employees to move over to the new employer.

In some circumstances, the rival firm to which a former employee moves may also be held liable where the move occurs in breach of an express contractual restraint clause (i.e. the rival firm may be found liable for inducing the breach of contract): see e.g. Wilson HTM Investment Group Limited and Others v Pagliari and Others [2012] NSWSC 1086.

iii. Is it necessary to pay an employee during the period of the covenant?

No, but this may be a relevant factor in determining the validity of a restraint clause (see section b. (iii) above).

E. OTHER COVENANTS: Are there any other types of employment- and post-employment-related covenants which are common in this jurisdiction?

Post-employment restraint clauses typically provide an employer with protection against a former employee’s use of the employer’s confidential business information or trade secrets, during the restraint period. This aspect of a restrictive covenant will be valid provided that it does no more than protect the employer’s legitimate business interests, and is reasonable in terms of its duration and geographical reach.
The kinds of information that may legitimately be protected in an express confidentiality provision in a restraint clause include information that the employer specifically designates as confidential (e.g. John Fairfax Publications Pty Ltd v Birt [2006] NSWSC 995), and information that was only made available to the employee because of the special nature of his/her position or role within the employer’s business (e.g. Smith v Nomad Modular Building Pty Ltd [2007] WASCA 169). However, protection would not extend to information that is readily available in the public domain (e.g. GlaxoSmithKline Australia Pty Ltd v Ritchie [2008] VSC 164).

So, for example, business operational information, financial data and reports, details of customers and suppliers, marketing/strategic plans, pricing models, and trade secrets such as manufacturing formulae or processes, would all constitute genuinely confidential information which may be the subject of protection through an appropriately worded restraint clause.

F. CHOICE OF LAW: What is the impact of the choice of law on the enforcement of a restrictive covenant?

Choice of law may become an issue in the enforcement of a restrictive covenant under Australian law in one of two ways:

1. Choice between Australian and foreign law: this could arise, for example, in relation to enforcement of a post-employment restraint against an employee of an overseas-based company working in Australia. In this situation, it is likely that an Australian state or territory court would apply the law applicable to restraint clauses in that state or territory – even if the contract had been entered into in an overseas jurisdiction (following the approach adopted in Rousillon v Rousillon (1880) 14 ChD 351). An alternative approach (based on Apple Corps Limited v Apple Computer Inc (1992) Fleet Street R 431 (ChD)) would see the Australian state or territory court being guided by the law nominated by the parties in their contract (i.e. the proper law of the contract). If they chose the law of an overseas jurisdiction to regulate their agreement, then the restraint of trade principles operating under that overseas law would be applicable. Conversely if they nominated the law of an Australian jurisdiction, that would be applicable. Although the issue has not been finally determined, the Rousillon approach is considered more likely to apply (see A Stewart and J Greene, ‘Choice of Law and the Enforcement of Post-Employment Restraints in Australia’ (2010) 31:2 Comparative Labor Law and Policy Journal 305, 322-326).

2. Choice of law among Australian jurisdictions: this is generally not a major issue given the similarities in restraint of trade laws operating throughout Australia, with the exception of the specific legislation operating in NSW (see section b. (ii) above). Given that the Restraints of Trade Act 1976 (NSW) provides employers with greater scope to enforce post-employment restraints than other Australian jurisdictions, it might be expected that employers would seek to make NSW the governing law of their employment contracts (perhaps, in some instances, artificially). However, this does not (in our view) occur to any appreciable extent. As outlined in section b. (ii), for the NSW legislation to apply, there must be a real and close connection between the employment contract and the State of NSW. In some cases, this has been expressed in terms of requiring that the proper law of the contract is NSW in order to attract the operation of the NSW legislation (see e.g. K.A. and C. Smith Pty Ltd Co v Ward (1998) 45 NSWLR 702; Professional Advantage Pty Ltd Co v Smart [2008] NSWSC 873, discussed in Stewart and Greene, supra, 326-328).

i. Can an employer impose a dispute resolution method on the employee?

Like the issue whether a restrictive covenant is included in an employment contract to begin with, the dispute resolution method that operates in respect of the covenant is a matter for negotiation between employer and employee. This will usually be determined by the general dispute resolution clause which the parties include in their employment contract; and/or the clause relating to the governing law applicable to the contract.
G. ENFORCEMENT: How are covenants typically enforced in this jurisdiction?

The usual remedy sought by an employer seeking to enforce a post-employment restraint is an injunction (on an interlocutory basis) restraining the former employee from taking up a new position, soliciting the employer’s clients or staff, and/or using confidential information in breach of the applicable restraint clause. The granting of such an injunction (pending a full trial of the matter) requires the employer to establish a prima facie case of breach by the employee of the restrictive covenant, and that the balance of convenience favours the injunction being granted (American Cynamid Co v Ethicon Ltd [1975] AC 396).

If an interlocutory injunction is granted, it is rare for the employer’s claim to proceed to trial. However, when that does occur, the other main remedy that is available is an order for damages to compensate the employer for any monetary loss suffered as a result of the employee’s breach of contract. For example, in Commercial & Accounting Services (Camden) Pty Ltd v Cummins [2011] NSWSC 843, the NSW Supreme Court awarded A$117,995 in damages following an employee’s misuse of confidential client information belonging to his former employer (although note that the employer’s action in this case was based on the equitable duty of confidence rather than a contractual restraint clause).

Importantly, an employer may not be able to obtain remedies to enforce a post-employment restraint where the employee has been wrongfully dismissed or made redundant: see e.g. Ecolab Pty Ltd v Garland [2011] NSWSC 1095.

H. SPECIFIC ISSUES RELATING TO EMPLOYEE BENEFITS, PENSIONS AND STOCK PLANS:

i. Do the same principles of enforcement outlined above at g. apply?

Under Australian law, the enforceability of post-employment restraints is a separate matter from the entitlements of employees under pension schemes (known in Australia as ‘superannuation’ entitlements) and stock plans. Employees are entitled to receive minimum superannuation contributions under federal legislation. These entitlements cannot be foregone in the event that an employee breaches a restrictive covenant (even if an employment contract made provision for such an arrangement, it would be unlawful). Stock plans are common for senior executives, through provisions setting out an employee’s share entitlements in the employment contract or a separate deed. This could conceivably include provision for the foregoing of share entitlements in the event of the employee’s breach of a restraint clause.

ii. Which covenants are typically imposed?

See (i) above.

iii. What sanctions are/can be imposed by the employer for non-compliance?

See (i) above.

iv. Are there any limits to what an employer can forfeit? (e.g. retroactively forfeit for matters prior to adoption of the forfeiture/claw back provisions)

See (i) above.

I. IMPACT OF INVALIDITY: What happens if a covenant is found to be invalid? Can a Court re-write the covenant or is it void?

Some aspects of a restrictive covenant which are found to be invalid may be struck out with the balance remaining enforceable, although this will depend on the form and substance of the particular clause (see sections a. and b.(ii) above). There is greater flexibility to read down an invalid restraint clause in New South Wales (see section b. (ii) above).

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